COMPTROLLER of MARYLAND
Serving the People

Peter Franchot
Comptroller

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Director
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February 28, 2011

Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21404

Honorable Thomas V. "Mike" Miller, Jr.
President of the Senate
State House
Annapolis, Maryland 21404

Honorable Michael E. Busch
Speaker of the House
State House
Annapolis, Maryland 21404

Dear Governor, President and Speaker:

As required by Maryland Tax-General Article Section 10-402, I am submitting this report on the impact of the change in the apportionment of income of manufacturing corporations from a three-factor formula of property, payroll and double-weighted sales to a single-factor formula consisting solely of sales. The change to the single-factor apportionment formula for manufacturers was adopted under Chapter 633, Acts of 2001, applicable to tax years beginning on or after January 1, 2001.

Our analysis finds that tax year 2008 corporate income tax revenues for corporations that were required to file the information report were about $12.6 million lower with the single factor apportionment than they would have been under the three-factor apportionment. In 2007, revenues were about $14.2 million lower; while, in 2006 revenues were about $19 million lower. This loss in 2008 equates to a reduction of about 9.0% of the $139.8 million tax year liability of all manufacturers and agricultural corporations (excluding refiners, who are exempt from using a single-sales apportionment), and about 1.6% of the total corporate income tax liability in 2008.

It should be noted that a small number of corporations greatly affect the net difference of $12.6 million due to higher Maryland modified income. The top ten companies with the greatest liability decrease under the single-sales calculation account for $19.9 million of the loss of revenue. On the other hand, the 10 companies with the greatest liability increase account for only $10.5 million of the offsetting revenue gain for the State. Without the changes associated with these 20 corporations, the net impact of the single-factor apportionment for manufacturers for tax year 2008 would have been a revenue loss of approximately $3.3 million.

This report represents information gathered from those corporations who returned Form 500MC through February 2011. The 500MC is used to gather tax information for multistate manufacturing corporations with more than 25 employees in order to help determine the effect of single sales and three-factor apportionment on these companies. Information from corporate income tax returns is based on returns processed through December 6, 2010, for tax year 2008. Because the 2009 tax return filing deadline for corporations that file on a fiscal year basis has not yet been reached, the tax return data from tax year 2009 is not yet complete. For this reason, the tax year 2009 analysis will be included in the 2012 report.

I hope you find this report informative. If you should have any questions or concerns regarding this report, please do not hesitate to contact me at 410-260-7450.

Sincerely,

David F. Roose

Attachment

cc. Comptroller Peter Franchot
Len Foxwell
Linda Tanton
Warren Deschenaux

SINGLE SALES FACTOR APPORTIONMENT FOR MANUFACTURING CORPORATIONS TAX YEAR 2008

Chapter 633, Acts of 2001 (Maryland Tax-General Article Section 10-402), altered the determination of how income of a manufacturing corporation that does business in Maryland and other states is allocated to Maryland for purposes of income taxation. Prior to enactment of the law, income was apportioned based on how much property, payroll and sales (double-weighted) were in Maryland relative to the whole. Under the new law, manufacturers' income is apportioned to Maryland based solely on the ratio of sales in Maryland to total sales. The change to a single-factor formula of sales reduces income tax liability for corporations with a relatively large presence in the State. Tax liability decreases when the average of the property and payroll factors is greater than the sales factor, and increases when the average is less than the sales factor.

Corporations with North American Industry Classification System (NAICS) codes 11 and 31 through 33 are required to attach a 500 MC to their return. Industries in NAICS code 11 are Agriculture, Forestry, Fishing and Hunting; the following manufacturing industries are included in codes 31 through 33:

311 Food	326 Plastics and Rubber Products
312 Beverage and Tobacco Products	327 Nonmetallic Mineral Products
313 Textile Mills	331 Primary Metals
314 Textile Product Mills	332 Fabricated Metal Products
315 Apparel	333 Machinery
316 Leather and Allied Products	334 Computer and Electronic Products
321 Wood Products	335 Electrical Equip., Appliances, & Components
322 Paper	336 Transportation Equipment
323 Printing and Related Support Activities	337 Furniture and Related Products
324 Petroleum and Coal Products	339 Miscellaneous
325 Chemicals	

A total of 1,526 corporations, with relevant NAICS codes, filled out a 500MC in tax year 2008, a total that was 537 higher than in tax year 2007. This increase may be the result of a checkbox that was added to Schedule B of Form 500, the corporate income tax return, in tax year 2008. This checkbox asks, "[i]s this entity a multistate manufacturer with more than 25 employees? If so, complete and attach Form 500MC to your Form 500." The filer is then asked to check a box for 'Yes' or a box for 'No,' the answer to which is captured in data processing. It is assumed that this checkbox informed some previously unaware corporations that they are required to fill out form 500MC, explaining the large increase in the number of 500 MCs for tax year 2008.

Based on information reported on 2008 corporate income tax returns, federal taxable income reported on all 4,673 non-refiner manufacturing returns totaled $3.3 billion; excluding negative values, total federal taxable income for those corporations was $102.0 billion. After statutory addition and subtraction modifications, positive Maryland modified income apportioned to Maryland using the single-factor formula totaled $1.7 billion. For 2008, the total tax liability on all 2008 returns of manufacturing (excluding refiners) and agricultural corporations as they were filed and processed was $139.8 million. Of the 4,673 returns filed by manufacturing corporations, 4,012 – or 86% – were unaffected by the change to the single-factor apportionment formula because they were not multi-state (1,486), or had no positive Maryland modified income (2,526).

For the 1,526 corporations that returned the information report, Form 500MC, tax liability increased by more than $10 under the single-sales formula for 325 corporations at an average of $57,137. For 231 corporations, tax liability declined by more than $10 by an average of $134,817. The remaining 970 corporations saw no significant change in tax liability between the two apportionment calculations.

Based on the information reported by the corporations who returned Form 500MC, the change from the three-factor method of apportionment to a single-factor method resulted in a revenue loss of $12.6 million for the State for tax year 2008, compared with a loss of nearly $14.2 million in 2007. This represents a decrease of 9.0% in the total 2008 tax liability of the non-refiner manufacturing and agricultural sectors, and about 1.6% of the total corporate income tax liability in 2008

The attached tables provide the revenue impact of the law change by three-digit NAICS code. Several industry codes were combined to avoid the disclosure of confidential tax information. The majority of the manufacturing industries saw an increase in tax liability under the single-sales calculation. The largest net decrease (approximately $3.5 million) occurred within industry code 334, Computer and Electronic Products. This is most likely due to the fact that the companies in this industry have a greater share of property, plant and equipment in Maryland than other manufacturing industries and that they were among the more profitable sectors. The Computer and Electronic Products industry accounts for 10.4% of the companies that reported, which is the fourth largest group after adjusting for disclosure. The industry with the largest net *increase* in tax liability under the single-sales formula was industry code 336, Transportation Equipment companies. The net increase was just over $1.2 million; this group makes up 5.7% of the companies that reported, the seventh largest group.

In addition to requesting tax and other financial data, Form 500MC also included two questions. For the first –which asked if the corporation was headquartered in Maryland – 157 corporations responded, "Yes," and reported that their tax liability was $14.1 million lower under the single-sales regime. The second question asked, "At any time after 2000, was Maryland sales transferred from the manufacturing company to a non-Maryland sales/distribution company?" To that question, 27 corporations answered affirmatively, reporting a reduction in tax liability of about $182,633 for tax year 2008.

It should be noted that the $12.6 million revenue loss provided in this report is not the actual impact of single-sales apportionment for manufacturing corporations since those corporations with fewer than 25 employees are not required to file the information report. For the tax year 2001 and 2002 reports, the information needed to calculate the impact for all corporations was required to be reported on page two of the corporations' Maryland tax returns and the reported revenue loss estimates included all of those corporations. It should also be noted that the change from a three- to a single- factor formula not only affects the apportionment of income by corporations, but also affects the apportionment of income by multi-state subchapter-S corporations with one or more nonresident shareholders, partners or members. While certain data is captured from returns of pass-through entities, the return is primarily for informational purposes and is not tied in an automated manner to the returns of its shareholders, partners or members where the calculation of tax liability is made. For this reason, the revenue impact from the change in apportionment formulas for this group cannot be determined.

NAICS Group		# Returns	Total Positive Taxable Income: Maryland Using: Single-Factor	3-factor	Change in Tax Liability: Increase #	Increase $	Decrease #	Decrease $	No change #	Net Change $
311-316	Food, Beverage & Tobacco, Textile Mills, Textile Product Mills, Apparel, Leather & Allied Products	168	315,415,285	342,596,841	50	6,467,415	37	(8,709,899)	81	(2,242,484)
321	Wood Products	30	1,291,588	1,990,577	-	-	5	(57,665)	25	(57,665)
322	Paper	30	5,101,527	8,626,087	6	138,827	4	(429,603)	20	(290,776)
323-324	Printing & Related Support Activities, Petroleum & Coal	55	34,033,661	38,565,009	6	271,124	10	(644,962)	39	(373,838)
325	Chemicals	185	105,580,860	115,786,444	35	1,985,193	31	(2,827,157)	119	(841,964)
326	Plastics & Rubber Products	54	3,910,521	7,198,014	6	51,662	11	(322,881)	37	(271,219)
327	Nonmetallic Mineral Products	57	4,472,242	5,123,613	10	90,706	7	(144,445)	40	(53,739)
331	Primary Metals	42	18,582,036	25,509,635	11	344,500	5	(916,029)	26	(571,529)
332	Fabricated Metal Products	146	34,155,733	63,398,370	31	414,927	29	(2,827,446)	86	(2,412,519)
333	Machinery	135	23,692,352	23,788,675	42	529,760	16	(537,711)	77	(7,951)
334	Computer & Electronic Products	158	83,593,382	125,626,613	23	1,323,318	16	(4,791,068)	119	(3,467,750)
335	Electrical Equip., Appliances, & Components	86	33,272,873	31,921,501	21	393,778	11	(282,296)	54	111,482
336	Transportation Equipment	87	202,607,588	187,475,519	14	4,800,697	11	(3,552,292)	62	1,248,405
337	Furniture & Related Products	36	6,524,473	5,412,247	10	203,113	5	(111,347)	21	91,766
110-115 & 339	Agriculture, Forestry and Logging, Fishing, Hunting & Trapping, Support Activities for Agriculture and Forestry, Misc. Manufacturing	257	240,078,496	281,695,130	60	1,554,576	33	(4,987,947)	164	(3,433,371)
Total		**1526**	**1,112,312,617**	**1,264,714,276**	**325**	**18,569,597**	**231**	**(31,142,749)**	**970**	**(12,573,152)**